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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Sections 12 and 19 of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-265
	)	
Development of Competition and Diversity in Video Programming Distribution and Carriage	)	

To: The Commission

PETITION FOR RECONSIDERATION AND CLARIFICATION

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Summary

Viacom International Inc. ("Viacom") hereby seeks reconsideration of the Commission's program access rules.

Viacom submits that economic data demonstrate that the Commission should adopt an exemption of the program access rules for any program service that is under common ownership with cable systems that account for fewer than five percent of the subscribers to that program service. Because such vertically-integrated firms cannot profitably engage in anticompetitive activities under any reasonable set of assumptions, the Commission can be assured that fashioning such an exemption will not result in the terms sought to be deterred by the Act.

Viacom also requests to clarify and modify certain other rules to avoid unwarranted results. Particularly, cable operators should be required to meet a higher threshold to establish that they "compete" with another distributor that may have received more favorable terms from a programmer.

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To: The Commission

PETITION FOR RECONSIDERATION AND CLARIFICATION

Viacom International Inc. ("Viacom"), by its attorneys and pursuant to Section 1.429 of the Commission's rules, 47 CFR § 1.429, hereby seeks reconsideration and clarification of certain aspects of the First Report and Order in MM Docket No. 92-265, FCC 93-178 (rel. Apr. 30, 1993) (the "Order"), which promulgated rules implementing Section 19 of the Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. (1992) (the "1992 Cable Act" or the "Act").

As demonstrated more fully below, Viacom submits that a de minimis exemption to the program access rules is warranted for any program service whose commonly-owned cable systems account for fewer than 5 percent of the total subscribers to that service.[1] Moreover, certain aspects of the Commission's new

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[1] As set forth in Viacom's Reply Comments in this proceeding, Viacom, by suggesting modifications to the Commission's rules, does not intend to suggest that either the (continued...)

rules will result in unintended and harmful consequences and should be modified in a manner that will achieve the objectives of the Act without causing undue harm to programmers.

I. The Commission Should Adopt an Exemption to the Program Access Rules for Any Program Service That Is Under Common Ownership with Cable Systems That Account for Fewer Than 5 Percent of the Subscribers to That Program Service

In its initial comments in this proceeding, Viacom urged the Commission to adopt a de minimis exemption to the program access rules for a program service whose commonly-owned cable systems served subscribers representing a very small percentage of the total subscribership to that service. Comments of Viacom in MM Docket No. 92-265, at 3-10. Because such program services have neither the incentive nor the ability to discriminate impermissibly against alternative technology distributors, Viacom proposed that the Commission fashion an exemption to cover circumstances in which a program service's commonly-owned cable systems account for fewer than 5% of the total subscribers to that service. Although the Commission initially declined to adopt any such exemptions to the program access rules "because the record [did] not provide sufficient data to support a definitive point at which the incentives for such vendors to

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[1](...continued) Act's provisions or the rules promulgated by the Commission are constitutional. Viacom reserves the right to challenge the constitutionality of both the statute and the Commission's implementing regulations.

favor their affiliated customers differ from other vertically integrated programming vendors," it stated that it would be willing to revisit the issue if such data were to be provided. Order at ¶33, n.19. Accordingly, Viacom, based on the economic data provided herewith, respectfully requests that the Commission revisit the issue and adopt an exemption to the rules for vertically integrated program services whose commonly-owned cable systems account for a relatively insignificant portion of that program service's total subscribership.

A. Economic Data Demonstrate That the Incentive to Discriminate Against Other Technologies Is Not Present When the Percentage of Subscribership to Commonly-Owned Cable Systems Is Relatively Insignificant

A vertically integrated entity derives its revenue from three primary sources: (1) per-subscriber license fees paid by distributors to program services; (2) the sale of national and local advertising on advertiser-supported program services; and (3) the retail fees paid by subscribers to the vertically integrated entity's commonly-owned cable systems. Because subscription to cable is driven by consumer desire to receive programming, there is a belief that vertically integrated entities have an incentive to deny their programming (or make programming available on less favorable terms) to alternative technology distributors in order to increase the number of subscriptions to commonly-owned cable systems. The program access rules have thus been designed to preclude a vertically integrated entity from acting in a manner that favors cable operators at the expense of alternative technology distributors.

A programmer's primary incentive is to maximize the distribution of its services. Denying programming to a potential distributor would, in most cases, result in less than maximum revenue from programming.[2] Thus, the Act recognizes that a non-vertically integrated programmer has no incentive to discriminate for or against any particular distributor. In contrast, a vertically integrated programmer may have an incentive to discriminate in the provision of programming if the increased revenue obtained from additional subscribers to its cable systems is sufficient to overcome the programming revenue foregone as a result of denying the programming to potential distributors. See Crandall, R and Glassman, M The Economic Case For A De Minimis Exemption From The Commission's Program Access Rules (attached as Appendix 1).

It should be beyond dispute that, at some point, the number of subscribers served by a vertically integrated programmer through its commonly-owned cable systems is simply too small for the programmer to forego potential revenue from other distributors in order to increase revenue from its cable system operations. Thus, for example, an entity that owned one cable system with the potential to serve 10,000 subscribers would have no incentive to deny its programming to alternative technologies

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[2] Revenue losses would result from decreased license fees as well as lower advertising revenue.

that could potentially provide several million additional subscribers to its program service. Just as the Act recognizes that there is no need to regulate non-vertically integrated programmers, there is no sound reason to shackle such a programmer with restrictive, expensive and burdensome regulations. The issue thus is merely to determine whether the captive subscribership standard proposed by Viacom provides sufficient assurance that a vertically integrated program service exempted from the rules has no incentive to discriminate against alternative technology distributors.

The attached economic study demonstrates conclusively that for virtually any reasonable assumptions concerning affected markets, there will be no ability or incentive to effectively discriminate against alternative technologies" at the captive subscribership level proposed by Viacom (i.e., less than 5 percent of total subscribership to the given affiliated program service). Id.

In making this determination, it is important to recognize that a vertically integrated entity can benefit from the denial of programming to an alternative distributor only in the geographic area in which the vertically integrated entity operates cable systems, and not in areas served by non-affiliated cable operators, for example. Id. Because programmers typically operate on a national basis and cable system operations are localized, pursuing a discriminatory strategy will limit potential program revenues on a national level in return for, in theory, increased revenue from cable operations only in localized areas.

It should also be noted that, given the number of program services available to distributors, even if a particular programmer were to deny alternative technology distributors access to its program service (or even several program services) only a limited percentage of the subscribers served by the alternative technology distributor would switch to a competitive cable system. Id. Studies demonstrate that the percentage of subscribers switching to a competitive cable system is based upon the number of remaining program services offered by the alternative technology distributor. Id. Thus, a vertically integrated programmer choosing to forego all revenues from alternative technology distributors would be able to gain at most a small portion of that technology's subscribers. As demonstrated in the economic study, at the de minimis level of network subscribers served by commonly-owned cable systems proposed by Viacom, even if the cable systems were to capture all of the subscribers lost by the alternative technology distributor in its area of operations, the increased revenue to the vertically integrated entity would be insufficient to overcome the lost programming revenue. Id. Indeed, this behavior would be unprofitable even if the assumptions used in the study are off by a wide margin.

In sum, the economic data amply support Viacom's contention that a program service that depends on its commonly-owned cable systems for less than 5 percent of its total subscriber base has no incentive to discriminate against alternative technology distributors.[3]

B. Viacom's Behavior in Serving Alternative Technologies Supports the Proposed Exemption

As demonstrated in its comments, Viacom, recognizing its need to maximize revenues from its program services, has marketed to all alternative distribution technologies on a nationwide basis. Comments of Viacom at 9. For example, distribution by SMATV, MMDS and HTVRO provides approximately 12% of the combined subscriber base of Viacom's premium services, Showtime and The Movie Channel. Viacom was also one of the first to license its program services to United States Satellite Broadcasting Company, Inc., a DBS operator scheduled to launch in early 1994. Viacom's marketing efforts are designed to raise the penetration level of its program services in <u>all</u> distribution technologies.

It is also in Viacom's interest as a programmer to increase penetration to alternative technology distributors in order to

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[3] The data also show that the mechanical application of the program access rules to programmers whose commonly-owned cable systems serve fewer than 5 percent of the subscribers to that program service will likely also have unintended results. For example, by driving such entities out of cable operation to avoid the harsh impact of the rules on vertically integrated entities, the rules could <u>increase</u> concentration of cable ownership (since existing cable operators are the most likely buyers of cable systems). Similarly, application of the program access rules could preclude many of the acknowledged benefits of vertical integration by discouraging small cable operators from investing in new programming. <u>Id</u>.

limit the bargaining power that cable operators have in their local markets. See Comments of Viacom at 56-57. Viacom's dependence upon access to cable systems in order to maximize penetration of its program services has allowed cable operators (especially the large MSOs) to obtain artificially low rates in return for carriage. The presence of healthy alternative technology distributors will dilute this bargaining power, reduce programmer dependence on cable operators for penetration, and thus enable Viacom (and programmers in general) to obtain more reasonable license fees from cable operators.

Thus, Viacom has a clear incentive to promote competition in the distribution field. Accordingly, based on the accompanying economic analysis, Viacom urges the Commission to adopt a de minimis exemption to the program access rules for any program service whose commonly-owned cable systems account for fewer than 5 percent of the subscribers to that service.

II. The Commission Should Clarify That a Complainant Has a Higher Burden of Proof if the Difference in the Price Charged to a "Similarly-Situated" Distributor Is More Than the Greater of 5 Cents or 5 Percent

The Commission's program access rules are designed, among other things, to prevent a vertically integrated programmer from discriminating against any multichannel video programming distributor in the "price, terms or conditions" of sale of the programmer's program service. 1992 Cable Act, § 19(c)(ii).[4] Under the program access rules, a distributor can bring a claim of discrimination merely by demonstrating that another distributor with which it does or proposes to compete has received more favorable terms from the vertically integrated programmer. Id. The Commission has recognized, however, that the "competing distributor" identified by the complainant may not be a proper point of comparison because of the presence of any one of a number of factors that the Act recognizes as legitimate bases for price differentials. Accordingly, the Commission has determined that, under its program access rules, a "discriminatory practice must involve the offering of the program service to similarly-situated distributors." Order at ¶98. Thus, in justifying the price charged (or other terms or conditions offered) to a complainant, a programmer may demonstrate that the proper comparison is between the complainant and a "similarly-situated" distributor, rather than the complainant and its "competitor." Id.

The Commission also has set forth the burden of proof that must be borne by a complainant to prove that improper discrimination has occurred. In this regard, the Commission states that a higher burden of proof is required of a complainant if the price differential is de minimis. Order at ¶ 133. A

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[4] For purposes of this pleading, the rules promulgated to implement Section 19 will be referred to generically as the "program access" rules.

price differential is considered de minimis for these purposes if it differs by no more than the greater of 5 cents or 5 percent from the price charged or offered to the complainant. Id.

It is unclear, however, if the determination of whether a price differential is de minimis is to be made by comparing the price charged to the complainant with the price charged to its competitor, or by comparing the price charged to the complainant with the price charged to the similarly-situated distributor. Since the Commission has acknowledged that a discriminatory practice must involve a "similarly-situated" distributor, the determination of whether the higher burden of proof applies should be made by comparing the price charged to the complainant with the price charged to the similarly-situated distributor. Accordingly, Viacom requests that the Commission clarify that, under Section 76.1003(d), once a programmer has demonstrated that the proper course is to compare the complainant with a "similarly-situated" distributor, the determination of whether the price differential is de minimis should similarly be made by comparing the price charged or offered to the complainant with the price charged to the similarly-situated distributor.

III. Because There Has Been No Finding That Cable Operators Have Been Discriminated Against in the Acquisition of Programming, the Commission Should Impose a Higher Burden on Cable Operators Seeking to Make a Claim of Discrimination

As set forth above, a discrimination complaint may be brought by demonstrating that a vertically integrated programmer has provided a "competing distributor" with more favorable terms. The Commission, in recognition of the Congressional determination that distributors using alternative technologies may have been subject to certain practices designed to limit their ability to compete with cable operators, has propounded an expansive definition of "competing distributor" for purposes of bringing a complaint under new Section 76.1002. See Order at ¶96. Specifically, a distributor need only demonstrate that "there be some overlap in actual or proposed service area" with another distributor that the complainant believes has received a more favorable contract than the complainant. Id. at ¶125 (emphasis added).

This generous (but, fundamentally, artificial) definition of competition was devised primarily to make it easier for alternative technology distributors to bring complaints of discrimination. Because Congress did not find that cable operators, except in the most limited circumstances, were constrained in their attempts to acquire programming, cable operators should not receive the benefit of the lenient standard adopted to aid alternative technology distributors. To do so would allow a cable operator who has entered into an agreement with a programmer on an arms-length basis to get out from under its bargain merely by comparing itself to an alternative technology distributor with a more favorable rate with which it overlaps to an insignificant extent, or by "overbuilding" a small portion of a neighboring cable system that has been able to negotiate a better deal. Under such an approach, the complainant cable operator would be able to obtain terms that it was unable to negotiate in the open marketplace. This result should not be countenanced -- much less encouraged -- by the rules.

In order to preclude this unwarranted result, Viacom submits that a cable operator seeking to bring a complaint of discrimination should be required to demonstrate that there is "substantial" overlap (*e.g.*, 50% of each distributor's service area) with the distributor that the cable operator claims has received more favorable terms or conditions. In this way, the Commission can preclude cable operators from gaining benefits unintended by the Act while ensuring that the rare cable operator who may have been subject to discrimination (such as a true overbuilder) will have a full opportunity to submit a complaint.

IV. The Commission Should Reconsider Its Decision to Reject Express Legislative History Indicating That, In Licensing Its Program Service, a Programmer May Consider Differences In Cost At the Distributor's Level

The Act's program access provisions allow a programmer to charge different prices to account for "actual and reasonable differences in the cost of creation, sale, delivery, or transmission of satellite cable programming." 1992 Cable Act, § 628(c)(2)(B)(ii). In its comments, Viacom demonstrated that the Act's legislative history makes clear that, by virtue of this provision, a programmer may consider differences in cost not only at the programmer's level, but also at the distributor's level. Comments of Viacom at 50. This furthers the public interest by allowing a programmer to obtain a market-based wholesale rate that is not the result of the unequal bargaining power enjoyed by cable operators, while still allowing for retail rate competition due to the lower fixed costs of alternative technology distributors.

The Commission, however, refused to acknowledge the import of the legislative history. Rather, it noted that comments were "divided" as to the appropriate interpretation of the colloquy between Senators Kerry and Inouye. Order at ¶ 107, n.177. The Commission, of course, must do more than tally up the comments supporting or opposing a particular point of view. Indeed, the comments on virtually every issue raised in this proceeding were "divided." Instead, the Commission should, after reviewing the comments, make a reasoned decision as to the proper course of action. Accordingly, Viacom again urges the Commission to utilize the construction of the statute that is crystal clear in the legislative history -- i.e., that a programmer may take into account differences in cost at the distributor's level in setting the price for its program service to a particular distributor.

V. The Commission Should Take Further Steps to Ensure That Complainants Are Not Able to Use the Complaint Process to Gain Access to Confidential Information

The Commission properly has determined that programmers submitting contracts or other proprietary information in response to a complaint brought under new Section 76.1002 should be able to request confidentiality to prevent widespread access to the information. See Order ¶¶ 78 n.103, 130. While Viacom recognizes that the Commission has taken substantial and

[illegible]

preclude the complainant (as distinguished from its outside attorneys) from viewing confidential or proprietary information.

VI. A Distributor Seeking to Alter An Existing Contract Should Be Required to Demonstrate That It Is Harmed by A Differential in Price, Terms or Conditions

In its comments in this proceeding, Viacom urged the Commission not to apply any rules promulgated pursuant to this proceeding to existing contracts. Such application is not required by the Act and raises serious constitutional issues. Comments of Viacom at 28-35. Viacom set forth a standard to determine the rationality of applying program access rules to existing agreements and concluded that application to such agreements presented serious constitutional problems.

Rejecting these arguments, the Commission determined that the rules adopted under Section 628 will be applied "prospectively to all existing contracts, whether they were executed before or after the effective date of the rules." Order, at ¶120. Accordingly, the Commission has directed that "[a]ll contracts . . . must be brought into compliance with the requirements specified in [its program access rules] no later than November 15, 1993." 47 CFR § 76.1002(f); see also Order at ¶122. Viacom reiterates its position set forth in its comments and requests the Commission to reconsider its decision.

In addition to discussing the constitutional infirmities of the Commission's approach, Viacom also urged the Commission to consider the severe upheaval that would result from the application of the rules to existing contracts. Comments of Viacom at 31. The Commission's action will cause a significant and fundamental disruption to the programming and other agreements into which programmers have entered. Id. These contracts are generally long-term in nature and are premised on the amount of revenues that the programmer anticipates it will receive from distributors under existing affiliation agreements. Any decrease in those projected revenues could preclude programmers from honoring their commitments to program suppliers.

In stating that contracts "be brought into compliance" with the rules, the Commission has determined that the interests of distributors outweigh those of programmers. If the Commission adheres to its determination to apply the rules to existing contracts, Viacom submits that there is an alternative course that will both satisfy the Act's requirement to protect the needs of alternative technology distributors and protect the investments of programmers -- in addition to avoiding the administrative and logistical nightmare of re-evaluating and reforming existing contracts in an exceptionally limited time frame.

Obviously, an alternative technology distributor with an existing affiliation agreement has not been "denied access" to the programming in question. Rather, the only concern is whether the price, terms or conditions of that access are discriminatory. As noted in its comments, Viacom has actively marketed its program services to alternative technology distributors upon terms that it believes to be fair and reasonable. Id. at 9. Under the rules, Viacom would incur very substantial administrative costs in the process of reviewing hundreds of existing agreements with distributors to examine the price and other terms of each of those contracts, even if no change in the terms of a given contract were ultimately called for.

Accordingly, Viacom proposes the following. Any distributor seeking to alter the terms of an existing contract based upon a claim under Section 628(c) should be required to demonstrate that the price, terms, or conditions of its affiliation agreement are such that the "purpose or effect" is to significantly hinder the distributor's ability to compete in the marketplace. In this way, only the contracts that could cause competitive harm would be subject to review. Of course, all agreements with distributors would be brought into compliance with the rules as they come up for renewal.[5] The alternative technology distributor will not be harmed as it will be ensured continued access to programming upon such terms and conditions that do not harm its ability to compete. Programmers will be helped by being able to honor their commitments and to make future plans based on realistic estimates of projected revenue. Consumers will also

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[5] Viacom recognizes that the Commission determined that behavior meeting the definitions of activities proscribed in subsection (c) are implicitly harmful. Order at ¶ 47. In this case, however, given the significant injury that may be suffered by programmers and, ultimately, subscribers (as a result of the rules' impact on programmers), Viacom submits that it is appropriate to require a showing of harm to demonstrate that an existing contract should be reformed.

benefit by having the ability to choose among competitive distributors without endangering the viability of the program services that they wish to receive. Accordingly, Viacom submits that the Commission should require a distributor seeking the reformation of an existing contract to demonstrate that its ability to compete has been harmed as a result of the price, terms or conditions of its agreement.

VII. CONCLUSION

Accordingly, Viacom submits that the Commission's program access rules should be modified and clarified as set forth above.

Respectfully submitted,

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Appendix

THE ECONOMIC CASE FOR A DE MINIMIS EXEMPTION FROM THE COMMISSION'S PROGRAM ACCESS RULES

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THE ECONOMIC CASE FOR A DE MINIMIS EXEMPTION FROM THE COMMISSION'S PROGRAM ACCESS RULES

The Cable Television Consumer Protection and Competition Act of 1992 ("the Act") directed the Federal Communications Commission (the "Commission") to establish regulations designed to deter certain practices of vertically-integrated entities (i.e., entities that own interests in both cable systems and program services) that found to be anticompetitive as a way of increasing competition and diversity in the programming marketplace. Viacom International Inc. ("Viacom") has proposed that a vertically-integrated program service be exempt from Section 628, the so-called program access rule, if the program service's commonly owned cable systems represent a very small percentage (fewer than 5%) of the program service's total subscribers. In this paper, we explain (and support with empirical analysis) that such a de minimis exemption is appropriate because a vertically-integrated program service which would qualify for the exemption would not have the ability or economic incentive to engage in anticompetitive behavior in dealing with alternative distributors.[1] In fact, we strongly believe that the Commission can be confident that the economic incentive to engage in such behavior would not exist even at subscriber levels significantly greater than the proposed 5% level.

[1] By alternative distributor, we refer to distribution technologies other than traditional cable television systems.

It is undisputed that vertical integration in the cable industry provides benefits through cost reduction, the creation of new program services and improved market intelligence, through, for example, market testing on commonly-owned systems. Further, regulatory costs associated with investigating and disposing of program access complaints will not be insignificant. Therefore, any rules hindering vertically-integrated competitors must be carefully drawn so as to have their intended effect without unnecessarily burdening such companies and the Commission. By adopting a de minimis exemption the Commission will be able to conserve its scarce regulatory resources, confident that consumer welfare has not been jeopardized and that Congress' mandate has been fulfilled.

We will also show that failure to establish a de minimis exemption to the program access rules will tend to compromise other important objectives of the Act and of antitrust policy. For example, lack of such an exemption will: (1) tend to cause an increase in concentration of cable ownership, contrary to the intent of the Act, and (2) provide an impediment to entry, especially by small companies, into cable programming, contrary to the spirit of the Act and of antitrust policy.

The remainder of this paper is divided into four parts. In Section I, we provide a discussion of factors that may encourage or discourage anticompetitive behavior against alternative distributors by vertically-integrated program services. In Section II, we develop an economic model that may be used to determine whether a vertically integrated program service with a <u>de minimis</u> portion of its subscriber base attributable to its commonly-owned cable systems would find it profitable to engage in anticompetitive behavior in its dealings with alternative distributors. In Section III, we discuss the adverse effects on competition that are likely to be incurred in various segments of the cable industry if a <u>de minimis</u> exemption is not adopted. Section IV contains a brief summary of our analysis.

I. <u>Factors Affecting Incentives to Engage in Anticompetitive Behavior</u>

The Act derives assumes that vertically-integrated firms with significant cable and programming interests might have an economic incentive to favor cable operators over their competitors. This favoritism would be designed to induce subscribers to shift their subscriptions from alternative distribution systems to cable systems. Such a strategy would make economic sense only if the programmer had a sufficiently high level of ownership in cable systems so that the lost profits